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Fitch: Skilled Nursing Beds Weigh on LPC Operating Performance

Fitch Ratings-New York-10 April 2024: Skilled nursing will continue to weigh on life plan communities' (LPCs) performance in 2024, even as skilled nursing occupancy improves and labor challenges begin to ease, Fitch Ratings says. LPCs with more independent living (IL) units relative to skilled nursing facility (SNF) beds will perform better than SNF-heavy LPCs given their ability to spread costs to IL business lines to cover SNF-related costs.

SNF-heavy LPCs, considered by Fitch as those LPCs where SNF beds comprise more than 20% of total units, experienced operational stress in Fitch's rated portfolio in 2023, with labor costs, inflation, tighter reimbursement and heightened government oversight pressuring skilled nursing expenses and revenues.

Of the eight LPCs downgraded in 2023 due to operational challenges (compared to downgrades driven by debt issuance), half were SNF-heavy LPCs, even though these LPCs make up just over a quarter of Fitch's rated portfolio. For these LPCs, SNF beds as a percentage of total units ranged from 23% to 61%. SNF-heavy LPCs also compose half of the 10 LPC ratings currently on Negative Outlook or Rating Watch Negative due to operational stress.

Many Fitch-rated LPCs have reduced their SNF beds in response to staffing and revenue pressures. Others have reduced external admits to focus, often exclusively, on taking care of their own residents. This active management of SNF beds, along with higher monthly IL rate increases close to or above inflation, helped LPCs absorb SNF-related operating pressures in 2023.

A leading indicator of the easing of the inflationary and staffing pressures has been lower monthly IL rate increases in 2024 in the 4% to 7% range, compared with 6% to 10% (and higher in some cases) in 2023. These IL rate increases should support the performance of LPCs in 2024, especially as IL occupancy continues to rise. The investment-grade (IG) median for IL occupancy was 92.5% in 2023, up from 90.7% in 2022.

However, SNF-heavy LPCs will continue to lag in performance, as the effect of IL rate increases, while helpful, remain diluted given the SNF exposure. SNF-heavy LPCs have been less able to reduce their SNF exposure and have a limited ability to raise rates, given that Medicaid and Medicare, which set non-negotiable rates, are a major component of SNF revenue, compared to IL revenue, which is private pay and has more pricing power. Three out of the four downgraded SNF-heavy LPCs were already rated below IG (BIG), indicating an already weaker operating risk assessment.

The IG SNF occupancy median improved in 2023 to 82.2% from 72.4% in 2022. The BIG median also improved but at 81% trailed the IG median. Preliminary 2024 data shows SNF occupancy continuing to rise. In response to improving SNF occupancy, some LPCs have brought SNF beds back on line, although not to pre-pandemic levels, and have begun to rebuild their skilled nursing staffing as monthly IL rate increases have helped cover staffing costs.

We expect LPCs to continue to redesign care to focus more on assisted living/memory care and home health care, all of which are largely private pay. Further IL expansions are likely, given the solid demand for IL units, especially larger units, and the support IL revenue has provided to LPC operational performance.

Fitch Ratings published an exposure draft that proposes revisions to its rating criteria for U.S. not-for-profit LPCs. One of the proposals is to cap the revenue defensibility assessment of SNF-heavy LPCs at ‘bbb’. Fitch is actively soliciting market feedback on the proposed criteria by April 18, 2024. Please see Fitch Ratings Publishes Exposure Draft for U.S. Life Plan Communities Rating Criteria for details.

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